

Service Date: May 9, 2000

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of the Joint Application of)	
Qwest Communications Corporation, <u>et al.</u> , and)	UTILITY DIVISION
U S WEST Communications, Inc., <u>et al.</u> , for)	
Approval of the Merger of Parent Corporations,)	DOCKET NO. D99.8.200
U S WEST, Inc. and Qwest Communications)	
International Inc.)	ORDER NO. 6199d

FINAL ORDER APPROVING MERGER

APPEARANCES

JOHN ALKE, Hughes, Kellner, Sullivan and Alke, 40 West Lawrence, Suite A, P.O. Box 1166, Helena, Montana 59624-1166, appearing on behalf of *U S WEST Communications, Inc.*

STANLEY T. KALECZYC, Browning, Kaleczyc, Berry and Hoven, P.C., 139 North Last Chance Gulch, P.O. Box 1697, Helena, Montana 59624-1697 and MARY ELLEN CALLAHAN, Hogan & Hartson, L.L.P., 555 Thirteenth Street, NW, Washington, DC 2000, appearing on behalf of *Qwest Communications Corporation*.

GREGORY T. DIAMOND, Davis Wright Tremaine, L.L.P. 2600 Century Square, 1501 Fourth Avenue, Seattle, Washington 98101-1688, appearing on behalf of *AT&T Communications of the Mountain States, Inc.*

MARK STAPLES, Staples Law Office, Penwell Building, 34 West Sixth Avenue, Suite 2A, P.O. Box 1018, Helena, Montana 59624-1018, appearing on behalf of *McLeodUSA*.

WILLIAM SQUIRES, Squires and Schontz, PLLC, 208 North Montana Avenue, Helena, Montana 59601-3837, appearing on behalf of *Mid-Rivers Telephone*.

MICHAEL S. LAHR, Crowley, Haughey, Hanson, Toole and Dietrich, 500 Transwestern Plaza II, 490 North 31st Street, P.O. Box 2529, Billings, Montana 59103, appearing on behalf of the *U S WEST Retirees*.

THOMAS MURI, Montana Consumer Counsel, 616 Helena Avenue, 3rd Floor, P.O. Box 201703, Helena, Montana, appearing on behalf of the *Montana Consumer Counsel*.

DENISE PETERSON, KATE WHITNEY, JAY DRISCOLL, SCOTT FABEL, advisory staff to the *Public Service Commission*, 1701 Prospect Avenue, P.O. Box 2601, Helena, Montana 59620.

Background

1. Qwest Communications Corporation (Qwest Corp) and affiliated companies (collectively "Qwest"), on behalf of their parent corporation Qwest Communications International Inc. ("Qwest Inc."), and U S WEST Communications, Inc. (U S WEST), on behalf of its parent corporation U S WEST, Inc. (jointly "Applicants") filed a joint Application with the Montana Public Service Commission (Commission) on August 19, 1999. Applicants requested an Order approving the proposed merger of Qwest Inc. and U S WEST, Inc., to the extent necessary and legally appropriate under Title 69, Chapter 3, Montana Code Annotated (MCA).

2. On September 3, 1999, the Commission issued a Notice of Application and Intervention Deadline.

3. The Application stated that on July 18, 1999, Qwest Inc. and U S WEST, Inc., executed an Agreement and Plan of Merger (Merger Agreement), to combine Qwest Inc.'s broadband Internet communications with U S WEST's local service offerings and high-speed Internet access through Digital Subscriber Line (DSL) technology. The boards of directors of Qwest Inc. and U S WEST, Inc., approved the Merger Agreement, subject to shareholder approval, the meeting of a number of conditions specified in the Merger Agreement and the receipt of requisite regulatory approvals. Applicants represented that the merger will serve the public interest by producing pro-competitive effects and benefits for the combined company's customers in Montana.

4. Qwest Inc., a facilities-based multimedia communications services provider, is a Delaware corporation traded on NASDAQ under "QWST." Its subsidiaries Qwest Corp., LCI, USLD and Phoenix are authorized to provide telecommunications services in Montana, and all but Phoenix are authorized by the Federal Communications Commission (FCC) to provide telecommunications services, including interstate interexchange and international telecommunications services, as non-dominant carriers.

5. U S WEST, Inc., is a Delaware corporation with subsidiaries providing integrated telecommunications services to 25 million customers in a 14-state region which includes Montana. In Montana U S WEST provides local telephone services, long distance services within specified calling areas, high-speed data networking, broadband personal communications services, print and electronic directories, operator services, and some limited video services.

6. As proposed in the Application, on closing, U S WEST, Inc. will be merged into Qwest Communications International, Inc. (Qwest Inc.), with Qwest Inc. continuing as the surviving corporation and U S WEST, Inc. ceasing to exist as a separate corporation. The direct and indirect wholly-owned subsidiaries of Qwest Inc. and U S WEST, Inc. that hold certificates or authorizations will survive as wholly-owned subsidiaries of the post-merger Qwest Inc. There will not be changes in the names of the subsidiaries; transfers of licenses, authorizations or certificates of authority; or assignments of assets. To comply with the Telecommunications Act of 1996, Qwest Inc. will discontinue and divest itself of all interLATA service in U S WEST's region before closing of the proposed merger.

7. On October 5, 1999, the Commission granted intervention to AT&T Communications of the Mountain States, Inc. (AT&T), McLeodUSA Telecommunications Services, Inc. (McLeod), Association of U S WEST Retirees (Retirees), and Montana Consumer Counsel (MCC).

8. On October 6, 1999, the Commission issued Order No. 6199, Procedural Order, setting forth the discovery schedule with a hearing date of January 26, 2000.

9. As requested by Applicants, the Commission issued Protective Order, Order No. 6199a, on November 17, 1999, separately providing protection for two kinds of information. "Proprietary Information" would be given to Commission Staff and Intervenor under the customary Protective Order requirements; and "Competitive Information" would be provided to Commission Staff and Montana Consumer Counsel Staff and experts (MCC) only, under special protection provided in the Protective Order.

10. AT&T and McLeod filed Motions for Reconsideration of Order No. 6199a (Protective Order), challenging the special protection of Competitive Information, which allowed only the Commission and MCC to have access under limited conditions. Intervenor maintained that by not having access to this information, they were unconstitutionally denied their due process rights and an opportunity to fully participate in the proceeding.

11. Intervenor, including MCC, also filed various Motions to Compel the filing of complete discovery responses. At a work session on November 30, 1999, the Commission suspended the Procedural Schedule in Procedural Order, Order No. 6199, ¶ 2, and vacated the hearing date of January 26, 2000.

12. At its work session on December 14, 1999, the Commission granted the outstanding Motions to Compel in general, and in particular overruled Applicants' objections to MCC's requests that were based on the Hart-Scott-Rodino Act. The Commission directed Applicants to file complete discovery responses by January 3, 2000 to the outstanding discovery, other than the Competitive Information data responses protected under the Protective Order. The Commission directed Applicants to file a non-confidential summary of the Competitive Information and a statement by December 20, 1999, detailing what other states in the western region are doing to protect this information.

13. On December 15, 1999, the Commission issued its Order Compelling Discovery and Summary, Order No. 6199b.

14. Applicants filed their Joint Statement Regarding Terms and Conditions of Other State Regulatory Commissions' Protective Procedures on December 17, 1999.

15. On December 20, 1999, Applicants filed two documents, Joint Statement Regarding Summary of Competitive Information and Joint Proposal Regarding Terms and Conditions of the Montana Public Service Commission's Protective Order Procedures. Applicants suggested allowing the competing Intervenor to have access to the Competitive Information, other than the Hart-Scott-Rodino Act Information requested by the MCC, under terms and conditions adopted by the Washington Utility and Transportation Commission (WUTC). Applicants proposed making the Hart-Scott-Rodino filing available at the local U S WEST offices in Helena to MCC and the Commission.

16. On December 22, 1999, the Commission issued Order No. 6199c, Order on Reconsideration, modifying the Protective Order No. 6199a to allow competing Intervenor access to the Competitive Information, other than the Hart-Scott Rodino filing, under restricted conditions. From the Competitive Information available to competing Intervenor, the Commission excepted the specific Hart-Scott-Rodino information requested by MCC, but modified the WUTC provisions for MCC's and the Commission's access.

17. On January 5, 2000, the Commission issued Notice of Commission Action Reinstating Procedural Schedule. The Commission set March 28, 2000 as the date for the commencement of the hearing. Applicants filed a Joint Motion to Advance Hearing Date (from March 28 back to March 21, 2000) and proposed a modified procedural schedule. The

Commission issued the Notice of Commission Action on January 27, 2000, modifying the Procedural Schedule in Order No. 6199, ¶ 2, and rescheduling the hearing date as requested.

18. The Commission conducted the public technical hearing in the Commission's Bollinger Hearing Room, 1701 Prospect Avenue, Helena, Montana, on March 21, 2000. The Commission also held a satellite hearing for the benefit of the public at the Double Tree Inn, 100 Madison Street, Missoula, Montana, on March 23, 2000.

19. At the hearing in Helena, Applicants put their Joint Motion on the record to expedite the hearing. Applicants moved to admit into the record the testimony, exhibits and appendices of all Intervenor witnesses without the requirement that the witnesses attend the hearing, sponsor their testimonies and withstand cross-examination. Applicants also moved that the testimony, exhibits and appendices of two of Applicants' witnesses, William E. Taylor and Mark T. Evans, be admitted into the record without the witnesses' appearances and moved that Mark Pitchford adopt the testimony of Paul Gallant and appear for cross-examination on that testimony. Further, Applicants moved that all the data responses be admitted into the record, as well as the Joint Application, and that the matter would be submitted on the stipulated record as recited in the motion. The Intervenors had no objection to the Joint Motion, and the Commission granted the motion and admitted the testimonies and data responses and exhibits into the record.

20. The following witnesses testified at the technical hearing in Helena on March 21.

Public Witnesses (U S WEST Retirees) -- Don Archibald, Robert E. Lee, W. Robert Korizek, Charles Vitullo, Janice Lincoln and Edward King.

Qwest – Mark Pitchford (adopting the testimony of Paul Gallant).

U S WEST – James B. Hayhurst and Wayne G. Culp.

21. The following public witnesses testified at the public satellite hearing in Missoula on March 23. The following company representatives responded on behalf of the Applicants.

Public Witnesses (U S WEST Retirees) -- Don Chugg, Helen I. Smith, Helen Sowrey, Ernest Kradolfer, Joann Salyer, David Line.

Other Public Witnesses -- Jim Erikson, CEO of Streaming Solution, based in Cutbank; and Russ Fletcher, CEO of Health Directory in Missoula.

Company Representatives – Jim Hayhurst for U S WEST and Doug Mitchell for Qwest.

22. At the conclusion of the technical hearing on March 21, 2000, the Commission set an expedited briefing schedule. Parties completed the briefing on April 17, 2000.

23. On April 26, 2000, the Commission received from AT&T a Notice of Withdrawal and from McLeodUSA a Motion to Withdraw from Proceedings. At its duly noticed work sessions on May 8, 2000, the Commission granted the withdrawal of these two parties from the proceedings. The Commission determined that their testimonies and data responses are properly part of the record.

FINDINGS OF FACT

SUMMARY OF TESTIMONY AND DISCUSSION

COMMISSION DECISIONS

24. In their joint application, Qwest and U S WEST requested Commission approval of their proposed merger to the extent necessary and legally appropriate under Title 69, Chapter 3, MCA. According to the application, the merged company will bring advanced voice, data and broadband Internet services to customers in Montana, the nation and the world. The Applicants stated the merger will combine Qwest's advanced broadband network with U S WEST's local service offerings and leadership in providing digital subscriber line (DSL) technology. The merger will produce significant procompetitive benefits, according to the Applicants, that will result in substantial benefits for customers.

25. Qwest and its subsidiaries currently provide telecommunications services nationwide, including toll, data and video services, as well as Internet access, web hosting, collocation and remote access. Qwest also provides high-volume voice and conventional private line services to other telecommunications providers, Internet service providers, and other data services companies. Qwest recently completed construction of a nationwide fiber optic network that extends 18,500 miles and connects more than 100 U.S. cities.

26. U S WEST provides telecommunications services through wholly-owned subsidiaries to 25 million customers in its 14-state region. U S WEST's telecommunications services in Montana include local telephone services, long distance services within specified calling areas, high-speed data networking, broadband personal communications services, print and electronic directories, operator services, and some limited video services. U S WEST serves about 376,000 residential and business access lines in Montana.

27. Under the terms of the merger agreement, upon closing U S WEST, Inc. will be merged into Qwest Inc., with Qwest Inc. continuing as the surviving corporation and U S WEST, Inc. ceasing to exist as a separate corporation. The direct and indirect wholly-owned subsidiaries of Qwest Inc. and U S WEST, Inc. that hold certificates or authorizations will survive as direct or indirect wholly-owned subsidiaries of the post-merger Qwest Inc. Applicants do not contemplate changes in the names of the subsidiaries; transfers of licenses, authorizations or certificates of authority; or assignments of assets. Under the Telecommunications Act of 1996, Qwest Inc. must discontinue all interLATA service in U S WEST's region before closing of the proposed merger and pledged in the application it will divest itself of those services before the closing. The post merger Qwest Inc. will have headquarters in Denver, Colorado.

28. In order to effect the merger, Qwest will issue shares of its common stock having a value of \$69 for each share of U S WEST common stock, subject to a "collar" on Qwest's average stock price between \$28.26 and \$39.90 per share. The number of Qwest shares to be exchanged by each U S WEST share will be determined by dividing \$69 by a 15-day weighted average of trading prices for Qwest common stock over a 30-day measurement period ending three days prior to closing, but will not be less than 1.72932 shares (if Qwest's average stock price exceeds \$39.90 per share) or more than 2.44161 shares (if Qwest's average stock price is less than \$28.26 per share). If necessary, the obligation under the "collar" may be satisfied in whole or in part with cash if Qwest's average stock price is below \$38.70.

29. The merged company plans to establish an Office of the Chairman whose members will be Philip Anschutz and Joseph P. Nacchio of Qwest and Solomon Trujillo of U S WEST. (The Commission notes that Solomon Trujillo recently announced he will not remain with Qwest after the merger but no information is available from this proceeding to shed light on what his resignation will mean for the proposed Office of the Chairman.) This office will act by majority vote and will be the final authority on all decisions. Upon completion of the merger, the Applicants stated the Qwest board of directors will consist of 14 members, including the three members of the Office of the Chairman, with a total of seven members to be designated by each entity. For a period of one year after the merger, the 20 most senior policymaking executives of Qwest will be drawn in substantially equal numbers from U S WEST and Qwest and each company will be proportionally represented at each level of senior management.

30. According to the Applicants, the merger will not adversely affect competition. They maintain that it will produce economies of scope and scale that will in turn lead to more service offerings and increased competition in market segments such as high-speed data and Internet access. The Applicants listed the following as public interest benefits:

- No adverse impact upon the continuity and quality of service provided to U S WEST's Montana customers. The post-merger company will accelerate the deployment of advanced services, which will increase competition in the broadband services market.
- Increased Section 271 incentives.
- Increased competition, lower prices and more choice.
- Ability of the combined companies to better meet competitive developments.

AT&T Testimony

31. AT&T witness Thomas Peltó testified that the proposed merger will have a substantial impact on U S WEST's service in Montana and urged the Commission to attach conditions to any merger approval. He claimed that, although U S WEST/Qwest, in their application and in public statements, have pledged to increase investment in local exchange facilities and have promised cooperation on local competition issues, they have not provided guarantees or written assurances to back up their promises. U S WEST/Qwest have, however, decided to invest substantially in advanced services, both inside and outside the U S WEST region, he said. According to Mr. Peltó, the Applicants have demonstrated their commitment to deploy advanced services, but have not committed to improving or even maintaining investment for local exchange facilities and services.

32. Mr. Peltó recommended that the Commission hold U S WEST/Qwest to their promises and minimize the negative impacts of the merger by conditioning approval of the merger. He urged the Commission to require, prior to closing the proposed merger, that U S WEST demonstrate compliance with, or be subject to enforceable penalties for failure to comply, a Commission-approved plan to implement the conditions generally described below.

- Require U S WEST to immediately meet its Sections 251/252 obligations. The 1996 Federal Act requires U S WEST to provide access to its local telephone markets to competitors via interconnection, unbundled network elements (UNEs) or resale, and to enter into interconnection and resale agreements with competitors.

- Require U S WEST/Qwest to submit for Commission approval Qwest's plan to divest itself of the interLATA services it currently provides in U S WEST's region. Mr. Pelto recommended that the Commission require: (1) the divestiture plan to comply with Sections 271 and 272 of the Act; (2) competitors to have access to any former Qwest interLATA facilities used by the merged company to provide local service; and (3) ratepayer revenues not to be used to recover the costs of those facilities and the merged company will not hoard those facilities.
- Require improvements in retail and wholesale service quality. Mr. Pelto recommended that the Commission require: (1) U S WEST/Qwest to adopt the 27 service quality measurements developed by the Local Competition Users Group, which would be reported monthly and entail self-executing performance penalties; and (2) U S WEST/Qwest to commit to raising the level of local exchange network investment to enable the merged company to meet the performance benchmarks.
- Reduce access charges to cost or to a level that reflects the savings resulting from the merger.
- Require detailed disclosure of transactions among and between U S WEST/Qwest affiliates and Commission approval of plans for the merged company's monitoring and disclosure of affiliate transactions.
- Limit U S WEST's ability to sell additional exchanges to finance the provisioning of advanced services by the merged company without increasing local service investment or reducing rates for retail and wholesale customers.

33. Mr. Pelto testified that there are many examples of U S WEST's failure to comply with Sections 251 and 252 of the Act. U S WEST resists negotiating interconnection agreements in good faith. U S WEST refuses to provide various UNEs thus violating the Act, such as requiring competitive local exchange carriers (CLECs) who want UNEs to access them through a SPOT frame, refusing to implement local number portability in compliance with FCC guidelines, refusing to provision number portability or loops outside of normal business hours except as part of a trial, refusing to provide UNE combinations to CLECs in violation of Supreme Court and FCC rulings, providing UNEs to CLECs that are not equal in quality to those U S WEST provides itself, failing to provision loops in a timely manner, failing to provide nondiscriminatory

CLEC access to advanced services and U S WEST's operational support systems, and refusing to share network "hot spots" information that would allow AT&T to prevent call blocking problems for its customers; and U S WEST refuses to comply with Act's collocation requirements.

34. Mr. Pelto argued that the proposed merger, as presented, is not in the public interest as long as the merger does not remedy the situation AT&T claims now exists in which U S WEST favors its affiliates and discriminates against CLECs. He testified that the post-merger company, which will have lost a potential competitor in Qwest and gained local and long-distance affiliates, will have incentives and increased opportunities to discriminate against competitors in favor of itself and its affiliates. In his opinion, since U S WEST/Qwest have refused to offer any guarantees that the merged company would meet its obligations under Sections 251 and 252, the Commission must condition its approval to ensure compliance with the Act and fully open U S WEST's local markets to competition.

35. Mr. Pelto explained that his recommendations for conditions relating to Section 271 compliance implicate this section of the Act in the merger because Qwest provides interLATA services, but U S WEST has not been granted 271 relief by the FCC that would allow U S WEST to offer in-region interLATA toll service. Therefore, Qwest must stop providing interLATA services in the U S WEST region before merging with U S WEST.

36. Although Qwest agrees it must divest some of its interLATA services, Mr. Pelto testified Qwest has not provided a divestiture plan with the details required to ensure compliance. The plan is insufficient because it does not provide a list of specific services that Qwest will divest, a timeline for divestiture, or the potential buyers of Qwest's interLATA services. He testified that if the merged company or another subsidiary uses the Qwest interLATA facilities to provide local exchange service, the Commission should require the facilities to be available to competitors, just as if it were U S WEST using the facilities to provide local service. However, if the merged company decides not to use all or some of the Qwest facilities until U S WEST is authorized to provide in-region interLATA service, it will still have to recover the facilities' costs, even though they are not generating revenues of their own. He urged the Commission to ensure that captive ratepayers do not end up paying those costs by excluding these assets' costs from U S WEST's rate base and by prohibiting the merged company from indirectly recovering them by diverting capital that should be invested in basic local phone service.

37. Mr. Peltó claimed that because Qwest is inexperienced in providing local exchange service and U S WEST's current level of retail and wholesale service quality is poor, service quality is an important merger review issue. He noted that Qwest's CEO Mr. Nacchio stated that the merged company will invest \$5.3 billion in service development, but did not provide details. Mr. Peltó said AT&T has been unable to obtain any specific answers from U S WEST/ Qwest about how that money will be invested, except for the statement that the companies have not yet developed a detailed budget plan.

38. According to Mr. Peltó, AT&T and other CLECs receive very bad service quality as access and wholesale customers of U S WEST. He cited examples of inadequate service to wholesale customers that U S WEST has failed to address: U S WEST's failure to provide service in a timely manner; numerous held orders; and U S WEST's refusal to provide local number portability in compliance with federal guidelines. He also claimed that U S WEST discriminates against CLECs by responding more quickly to its affiliates' maintenance and repair requests than to CLECs' and by refusing to share network information that would allow competitors the same ability to respond to customers' requests that U S WEST's affiliates have.

39. Mr. Peltó cited service quality proceedings against U S WEST undertaken by several commissions, including Montana's, as evidence of service quality problems. He claimed that U S WEST/Qwest's application and responses to data requests indicate the merged company will not focus on improving basic local service to retail and wholesale customers, but will instead shift investment away from basic service and facilities to advanced data services. To prevent deterioration of service quality, he urged the Commission to require the merged company to meet certain wholesale performance measurements prior to merger approval, an approach he said had been used in other merger proceedings.¹ He proposed that failure to meet the performance targets should result in automatic fines and penalties.

40. Mr. Peltó also recommended that the Commission require the merged company to submit a detailed infrastructure investment plan for Commission approval as well as requiring annual investment reports that would be audited by the Commission.

¹ See Exhibit B of Mr. Peltó's testimony for a list of AT&T's 27 proposed performance measures.

41. Mr. Peltó addressed the issue of access charges. He said that the Applicants indicated the merger will produce cost savings but failed to provide information about whether increased productivity and increased assets will translate into reduced access charges for competitors. According to Mr. Peltó, the proposed merger could lead to a “price squeeze” by the merged company that would adversely affect competition in the state and reduce affordable options for consumers. He feared that U S WEST will continue to charge access rates to long-distance competitors that are above costs, which will enable the company to offer lower long distance rates to consumers than competitors can. He also noted that Qwest’s affiliates now paying access charges to U S WEST as providers of toll service will, after the merger, be paying those intraLATA access charges to their own affiliate – U S WEST. He argued that these access charge payments will simply be intracompany transfers and the merged company will actually save money. If Qwest/U S WEST wins Section 271 approval to offer in-region interLATA toll service, he testified the potential for a price squeeze expands accordingly. He recommended that the Commission require the merged company to reduce access charges to cost-based levels.

42. On the subject of affiliate transactions, Mr. Peltó commented that U S WEST/Qwest did not provide a meaningful explanation of the post-merger relationships among the two companies’ various affiliates. He recommended that the Commission attach conditions to require detailed disclosure of affiliate transactions, that U S WEST/Qwest be required to commit to compliance with orders regarding joint marketing of services and other affiliate transactions, and that the merged company be required to structurally separate its wholesale and retail activities into separate operations.

43. Mr. Peltó also expressed concern that the merged company might divest itself of rural exchanges because U S WEST/Qwest have not provided any information about its plans for service in rural areas. He proposes the Commission place a three-year moratorium on sales of local exchanges after the merger and require the merged company to improve service quality in rural exchanges.

U S WEST/Qwest Rebuttal

44. James B. Hayhurst testified on behalf of U S WEST, primarily rebutting the testimony of AT&T. He argued preliminarily that AT&T raised wholesale service quality and

other issues that are not relevant to the proposed merger and that the Commission lacks jurisdiction over the merger.

45. Mr. Hayhurst claimed that AT&T made unsupported allegations in its testimony and many of those allegations are not Montana-specific or relevant to Montana. He dismissed Mr. Pelto's claims of the negative outcomes that could result from the merger as unfounded and speculative. He argued that AT&T's recommendations that the Commission deny or at least condition the merger do not take into account the fact that nothing about the Commission's regulatory oversight over U S WEST's regulated operations will change as a result of the merger. Hayhurst noted that if the Commission believes the post-merger U S WEST is violating any laws or rules, the Commission retains the authority it has today to address those problems.

46. Mr. Hayhurst refuted AT&T's claims that U S WEST does not comply with Sections 251 and 252 of the Act, asserting U S WEST has spent more than \$1 billion on providing competitive local exchange carriers (CLECs) with access to interconnection, UNEs, resale, number portability and OSS and has created a Wholesale Division to serve CLECs. He recounted the numbers of trunks, resold lines, unbundled loops and collocations that have been provided regionwide and in Montana and pointed out U S WEST's implementation of local number portability and intraLATA dialing parity, establishment of a processes and procedures regarding interoperability, and enhancements made to its OSS interfaces.

47. Mr. Hayhurst stressed the importance to the merged company of obtaining Section 271 approval to offer interLATA services in the region, which he said creates a huge incentive for U S WEST to improve wholesale service quality.

48. Mr. Hayhurst testified that it is unnecessary for the Commission to adopt conditions or require commitments from U S WEST/Qwest prior to granting merger approval because the Act and FCC orders have established regulatory mechanisms for U S WEST to comply with market opening requirements and, further, the Commission is able to address any of these issues in other more appropriate proceedings.

49. Regarding Mr. Pelto's testimony alleging that U S WEST was not complying with Sections 251 and 252 of the Act, Mr. Hayhurst stated generally that the allegations of noncompliance are unsubstantiated. On specific 251/252 issues raised by Mr. Pelto, Mr. Hayhurst made these points:

- Spot frame -- He disputed the claim that U S WEST requires UNEs to be provisioned via a spot frame. Mr. Hayhurst said this is not true and that the Montana Commission deferred this issue to the Section 271 proceeding. He said that U S WEST believes the spot frame is the best way to provision UNEs and that nearly 600 loops in Montana are provisioned this way. Other CLECs have supported use of the spot frame, according to Hayhurst, and even AT&T has supported it for individual UNEs.
- Collocation – Mr. Hayhurst claimed that, contrary to Mr. Pelto’s allegation, U S WEST allows for the collocation of remote switching units (RSUs). He further testified that U S WEST complies with all legal requirements for collocation and noted that AT&T has not requested collocation in Montana to date. The merger conditions proposed by Mr. Pelto for collocation (except for performance measurements) are the same as the requirements of the FCC’s 706 order on collocation, so it is unnecessary for the Commission to act further in this regard because U S WEST already complies with this order. He stated that U S WEST already complies with at least 10 of the 12 collocation-related conditions found on pages 20-21 of Mr. Pelto’s testimony. Mr. Hayhurst said that U S WEST does not agree with the proposed condition regarding liquidated damages, which he said is not a requirement of the Act and which is similar to the DMOQ proposal the Commission rejected in the U S WEST/AT&T arbitration.
- Integrated Digital Loop Carrier, packet switching, DSL – According to Mr. Hayhurst, U S WEST provides access to these products in compliance with FCC orders.
- Merger conditions regarding operational support systems (OSS) – Mr. Hayhurst testified that Mr. Pelto’s proposals for merger conditions in this area are misplaced and should be addressed in Section 271 proceedings. U S WEST’s OSS are already going to be tested by an independent third party in the ROC-OSS testing effort.
- Interconnection agreements – Mr. Hayhurst disputed the contention that U S WEST has negotiated interconnection agreements in bad faith by pointing out the 69 interconnection agreements that have been approved in Montana, only two of which went to arbitration.
- “Pick & choose” – Mr. Hayhurst said that Mr. Pelto did not accurately state U S WEST’s policy on allowing CLECs to select provisions from other CLECs interconnection agreements. U S WEST complies with Section 252(i) of the Act, he said.

- Other proposed merger conditions related to Sections 251 and 252 (pick and choose, reciprocal compensation for ISP traffic, provision of UNEs) – Mr. Hayhurst stated that the conditions are unnecessary because U S WEST will comply with the FCC orders on these when they are legally binding and effective.

50. According to Mr. Hayhurst, there is no basis for the Commission to find that U S WEST does not comply with Sections 251 and 252; therefore, the Commission should ignore AT&T's proposed conditions.

51. Mr. Hayhurst claimed that Mr. Pelto's testimony regarding service quality contained unsupported allegations that relied on anecdotal or mischaracterized information, all of which came from states other than Montana. According to Mr. Hayhurst, the Commission has the regulatory authority to address any U S WEST service quality issues and will continue to have it after the merger, and U S WEST is already undertaking service improvement activities. Mr. Hayhurst pointed out that Section 271 of the Act gives U S WEST the incentive to provide quality wholesale service. On specific service quality issues raised by Mr. Pelto, Mr. Hayhurst made these points:

- Meeting installation commitments – Mr. Hayhurst testified that U S WEST met its due dates for DS1 91.5% of the time in 1999, not 59.31% as alleged. He said that U S WEST meets more than 97% of its commitments for CLEC business installations.
- AT&T access complaints – According to Mr. Hayhurst, these complaints are pending in five states, not including Montana, and U S WEST believes it will prevail.
- Discriminatory treatment of wholesale customers – Mr. Hayhurst testified that the allegations in this regard are unsubstantiated and referred to the statistical data on service performance provided by U S WEST.
- Service quality proceedings in other states – Mr. Hayhurst claimed that these proceedings referred to by Mr. Pelto are not specific to Montana and are therefore not relevant to this merger review.
- Deployment of advanced services to the detriment of basic service – Mr. Hayhurst disputed Mr. Pelto's contention that U S WEST/Qwest might focus on advanced services and neglect basic service by testifying that U S WEST, like other prudent telecom companies, is increasing its advanced services offerings, but that many of these offerings,

like xDSL, rely on the same copper infrastructure that the local network uses. He noted again that U S WEST invested more than \$4 billion region-wide in its local network.

52. Mr. Hayhurst asserted that the service quality conditions proposed by Mr. Pelto are unwarranted. He stated that wholesale service quality issues will be addressed in the Section 271 process and added that wholesale customers' interconnection agreements with U S WEST include provisions for service-related activities and trouble reporting.

53. Qwest witness Paul Gallant rebutted AT&T's allegations that Qwest's divestiture plan is inadequate. He argued that Qwest's October 1999 plan as filed with the FCC and the Commission adequately details Qwest's plan to divest its interLATA services. Specifically, he said the plan calls for Qwest to divest the following:

- Originating interLATA switched long distance service;
- InterLATA 800 service terminating in-region;
- Originating and terminating interLATA private line voice and data service;
- In-region interLATA calling card, prepaid cards, and operator assisted services; and
- In-region interLATA transmission component of dial up and dedicated Internet access services and Internet based hosting services.

54. According to Mr. Gallant, the sale of these services is final, irrevocable and the buyer is not obligated to allow Qwest to re-acquire customers.

55. U S WEST/Qwest witness William E. Taylor rebutted the intervenor claims the merger will increase the likelihood and incentive of the merged company to practice anti-competitive behavior. Dr. Taylor cited the Department of Justices' decision to not take any additional action as proof the merger is in the public interest and not anti-competitive.²

56. Dr. Taylor rebutted Mr. Pelto's claim that, once merged, the company will be able to "squeeze" competitors out of the market by lowering retail costs to a point that competitors will be unable to compete against the merged company. He argued that price squeeze can only be profitable in the long run if: (1) the ILEC can drive interLATA competitors from the market; and (2) sufficient entry barriers are erected to the point competitors will be unable to enter the market once the ILEC raises its retail prices to recoup lost profits. Both scenarios are unlikely

² Rebuttal testimony of William E. Taylor, p. 11

57. because price squeeze (i.e., anti-competitive pricing) could not reduce IXC profits sufficiently to drive them out of the market. Ubiquitous scope and scale prevents price squeeze as an attainable market strategy in the interexchange carrier market today. Additionally, facilities would be available to the next competitor, thus preventing U S WEST/Qwest from raising long distance prices to recoup losses.

58. Dr. Taylor refuted AT&T's claims that the company will engage in non-price discrimination by identifying four reasons why he believes these claims are without merit: (1) the ILEC can not practice non-price discrimination while retaining retail customers; (2) there is potential market share loss; (3) such practice would delay Section 271 relief; and (4) the FCC may possibly revoke Section 271 relief.

59. On the merged companies' procedures for handling affiliate transactions and instituting accounting safeguards, U S WEST witness Wayne Culp summarized U S WEST's accounting safeguards, planned divestiture of interLATA services, and handling of affiliate transactions, specifically citing Part 32.27 of the FCC rules. These standards are reflected in the Uniform System of Accounts for Telecommunications Companies. Part 32.27 provides a pricing hierarchy, which provides:

(1) Services that are sold or purchased under a tariff should be charged to the affiliate at the tariff rate.

(2) Services not sold or purchased under a tariff but sold to unaffiliated companies should be charged at the prevailing company price.

(3) Services sold that are neither in a tariff or sold to an unaffiliated entity will be recorded at the higher of fully distributed cost (FDC) or fair market value (FMV) and services purchased are recorded at the lower of FDC and FMV.

60. Mr. Culp stated that it is not possible for U S WEST to use revenues from ratepayers to recover costs for Qwest's interLATA network as a merge company as long as it follows Part 32 rules and regulations. He argued it is not necessary for U S WEST to submit a plan for interLATA cost recovery due to the accounting safeguards in Part 32 because those safeguards provide the mechanism that protects the ratepayer from being charged for services provided by an unregulated affiliate. By following part 32.27, the ratepayers are protected from cross-subsidization of costs. Commission Order No. 5354g issued in Docket 88.1.2 addresses

affiliate relationships and requires U S WEST to provide sufficient information for Commission review of affiliate transactions. Under the terms of that order, according to Culp, by May 1st of each year, U S WEST must file an affiliate report with this Commission. The affiliate report includes prior years' transactions, affiliate changes, costing methodologies, and intrastate amounts paid to affiliates and by affiliates, as well as an explanation of year-over-year variances of plus-or-minus 10 percent. Mr. Culp stated that U S WEST is committed to following the rules and regulations of this Commission and the FCC. By doing so, he contended, there will be no opportunity for the merged company to cross-subsidize services through revenues obtained from U S WEST's basic local services and U S WEST and Qwest can not fund any expansion plan on the backs of Montana's ratepayers.

COMMISSION DECISION

61. The Commission determines that it is inappropriate to address in this proceeding many of the issues raised by AT&T because they are outside the scope of a merger review of this type. The Commission notes that the Federal Communications Commission (FCC) made a similar determination regarding this merger.³

62. The Commission also determines that improvement in implementing the goals of the Montana Telecommunication and the Federal Act in promoting competition in the local exchange market progressed because of this Commission's review of the merger. New and not so new issues were brought to the Commission's attention by the intervenors that will be addressed in future proceedings. The Commission fully expects the parties to work cooperatively in settling disputed issues in these upcoming proceedings.

63. AT&T's proposals for merger conditions related to U S WEST's Section 251/252 local competition obligations will be more appropriately addressed when U S WEST seeks a positive recommendation from this Commission to the FCC on a future Section 271 relief application. While interconnection to U S WEST's network is vital to increasing competition in Montana, the issue is outside the scope of this proceeding. Service quality provided by U S

³ See, In the Matter of *Qwest Communications International, Inc. and U S WEST, Inc. for the Transfer of Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License*, CC docket No. 99-272, Memorandum Opinion and Order, FCC 00-91 (released March 10, 2000).

WEST to its wholesale customers will also be an important issue in that future proceeding, as will a post-Section 271 entry performance assurance plan, and will not be addressed in this order.

64. AT&T devoted much of its testimony to its concerns that retail and wholesale service quality may suffer as a result of the merger because the merged company will shift investment away from basic service and facilities to advanced data services. AT&T recommended merger conditions that would require the merged company to raise the level of network investment, submit detailed infrastructure investment plans for Commission approval, and meet certain wholesale performance standards.

65. The service provided by U S WEST to customers in Montana has long been a concern of this Commission. The Commission sued U S WEST over alleged violations of service quality rules in 1994 and, as the result of a settlement agreement, U S WEST implemented a service improvement program from 1996 to 1998 to bring its installation and repair service up to agreed-upon levels. U S WEST also implemented a program that continues today under which customers waiting too long for service to be installed receive either a cellular loaner phone until their U S WEST service is working or a \$100 bill credit for each month they wait for service. Service quality reports from U S WEST to Commission staff for the months of April through November 1999 that were submitted by U S WEST as a discovery response in this proceeding indicate there is room for improvement in U S WEST's current retail repair and installation service performance.⁴

66. U S WEST itself has acknowledged that service quality is an issue. In a news release dated October 25, 1999,⁵ U S WEST chairman and president Sol Trujillo announced the company's "service improvement initiative," under which the company said it had increased its regionwide capital spending by more than \$1 billion for 1999 to invest in network improvements, hire more employees, improve training programs and implement new technologies. Mr. Trujillo pledged by the end of 1999 to reduce held orders by 30 percent and to repair 65 percent of out-of-service trouble reports within 24 hours. According to the September 28, 1999, edition of the *Denver Post*, Qwest chief executive officer Joseph Nacchio sounded the same theme in a speech to the U S WEST Regional Oversight Committee when he was quoted as saying:

⁴ U S WEST response to data request AT&T 01-085 S1, Attachment B

⁵ U S WEST response to PSC 1-042, Attachment A.

I know there are service issues. I know there also are issues about local competition. It's our belief that Qwest's merger with U S WEST will improve both of these issues.⁶

67. The Commission is concerned about the Applicants' failure throughout this proceeding to provide specific commitments regarding maintaining and improving service in Montana to back up their promises that service quality will be maintained at its current level or even improved after the merger. The Applicants have estimated that, as the result of the merger, the combined company will achieve operating expense savings of approximately \$4.3 billion and capital expenditure savings of approximately \$2.2 billion over the years 2000 through 2005.⁷ In addition, Qwest's CEO Mr. Nacchio pledged that the merged company would commit \$5.3 billion it will receive over five years as a result of a reduction in the shareholder dividend to "service development."⁸ Attempts to discover how much of the Applicants' projected cost savings from the merger or the promised \$5.3 billion for service development would be used for network infrastructure investment in Montana were uniformly met with the response that specific decisions as to how the merged company will use the cost savings or the \$5.3 billion have not yet been made.⁹

68. The record is replete with Applicants' statements that service quality will not deteriorate after the merger.¹⁰ The record is also full of the Applicants' refusals to be pinned down regarding what specific plans are in place to fulfill that promise.¹¹ In an effort to ensure that U S WEST's network and service are maintained at least at their current level after the merger, the Commission directs U S WEST to budget its capital expenditures in Montana for the next two calendar years at least at the same level as they have been the past two calendar years. This direction means that U S WEST will budget a minimum of \$50 million in each of the next two calendar years (2001 and 2002) for capital expenditures in Montana for infrastructure modernization and maintenance to maintain existing levels of service and to achieve telephone

6 "Qwest CEO Says Service Will Improve," *Denver Post*, September 28, 1999, page A-01.

7 Applicants' Joint Proxy Statement, p. II-16, filed in response to MCC 1-010, Attachment A.

8 AT&T 1-021.

9 U S WEST responses to AT&T 1-005, AT&T 1-019, AT&T 1-020, AT&T 1-021, AT&T 005S1, PSC 1-008, PSC 1-015(d), PSC 1-017, PSC 1-037, PSC 1-042, McLeod 2-009, McLeod 2-010.

10 For examples, see Application, p. 9 and p. 11, as well as U S WEST responses to PSC 01-015(d), PSC 01-017, PSC 01-41, PSC 01-042, PSC 01-048, PSC 2-101.

11 For examples, see U S WEST responses to AT&T 1-005, AT&T 1-019, AT&T 1-020, AT&T 1-021, AT&T 005S1, PSC 1-008, PSC 1-015(d), PSC 1-017, PSC 1-037, PSC 1-042, McLeod 2-009, McLeod 2-010.

service improvement. The \$50 million amount retains the 1999 and 2000 Montana-budgeted capital expenditure level, an amount that was provided by U S WEST witness Mr. Hayhurst at the hearing (Tr. pp. 117-120).

69. In addition, the Commission requires U S WEST's actual gross construction expenditures for calendar years 2001 and 2002 to be maintained at least at the level of the historic 5-year average (1995-1999) of actual gross construction expenditures (minus the Tele-Tech expenditures for years 1995 and 1996). In order to determine the historic 5-year average expenditure level, U S WEST is directed to file a report of each of those year's Montana actual gross construction expenditures with the Commission within 10 days of this order.

70. U S WEST also is directed to retain its cellular loaner alternative/bill credit program for held order customers that is now in effect for no less than two years following the merger closing date unless the Commission and U S WEST mutually agree otherwise.

71. The record does not support the implementation of a retail service performance plan with incentives included that would help ensure that service quality to retail Montana customers will improve or at least be maintained at present levels after the merger. AT&T and McLeod both proposed detailed wholesale service quality performance plans, but their concerns over service quality did not extend to submitting retail service quality proposals.¹² The Montana Consumer Counsel (MCC) recommended only that the Commission monitor the service performance of the merged company. When asked specifically to provide a recommendation for a retail service performance plan, MCC declined and replied that the Commission already has retail service standards in place and that monitoring compliance with them and revising the standards will be a continuing job.¹³

72. In the absence of parties' proposals to address retail service quality problems with service performance plans in this proceeding, the Commission will instead closely monitor U S WEST's retail service performance for compliance with Commission service standards after the merger, as it does now. If the service provided by U S WEST to its customers fails to meet the Commission's service standards after the merger, then the Commission has the authority under state law to take the matter to court to remedy the situation.

¹² AT&T response to PSC-79, McLeod response to PSC-83.

¹³ MCC response to PSC-81(b).

73. The Commission takes exception to U S WEST's claim that the existing service standards are outdated and the implication that they are not in effect. Until the existing service standards are revised, the existing standards are in effect and are the measures U S WEST is required to meet. The Commission does not agree that the majority of the existing standards are outdated. Rather, the current effort to revise them is prompted by the difficulty the Commission has experienced in determining U S WEST's compliance with them because U S WEST does not track its performance in a manner that directly corresponds to the standards.

74. It is not necessary or appropriate in this proceeding to consider AT&T's and McLeod's wholesale service performance proposals because service quality to wholesale customers will be addressed in a future Section 271 proceeding, as well as on an ad hoc basis as complaints are received and in development of carrier-to-carrier service quality rules.

75. AT&T raised concerns regarding Qwest's plan to divest itself of the interLATA services it currently provides in U S WEST's region. In its decision regarding this merger, the FCC conditionally approved the merger of Qwest and U S WEST upon the full divestiture of Qwest's interLATA business in the 14-state U S WEST region in a manner that would satisfy Section 271.¹⁴ The FCC found the merger would serve in the public interest by increasing U S WEST incentives to satisfy the requirements of Section 271 of the Act so that it would gain earlier approval to provide in-region interLATA services. The FCC also found the merger would promote the deployment of advanced telecommunications services. The FCC required Qwest to file a more complete report on the divestiture, and specified a number of topics that the report must cover. The FCC is currently deliberating Qwest's divestiture report, and is expected issue a decision in late June 2000. The Montana Commission expects that the FCC will make a complete and informed decision regarding the divestiture of Qwest's interLATA network in accordance with Section 271 restrictions.

76. The Commission agrees with the FCC that the merger is in the public interest with the conditions contained herein. The Montana Commission also believes that the incentive of U S WEST to meet Section 271 approval is enhanced with its merger with Qwest. Full

¹⁴ See, In the Matter of *Qwest Communications International Inc. and U S WEST, Inc. for the Transfer of Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License*, CC docket No. 99-272, Memorandum Opinion and Order, FCC 00-91 (released March 10, 2000).

divestiture of Qwest's interLATA network that complies with Section 271 of the 1996 Act is fully expected by this Commission. While this Commission acknowledges AT&T's concerns, the issue is federal in nature and the responsibility of the FCC.

77. AT&T has proposed that U S WEST and Qwest be required to provide detailed disclosure of their transactions with their affiliates. However, the Commission agrees with U S WEST and determines that Commission Order No. 5354g in Docket 88.1.2 and U S WEST's annual reporting requirement are sufficient to provide disclosure of affiliate transactions. Disclosure needed to review affiliate transactions is already required by the Commission, as well as by the FCC.

78. AT&T recommended that the Commission reduce U S WEST's carrier access charges to reflect merger cost savings and synergies. The Commission determines the access charge issue to be outside the scope of this proceeding. The access charge issue may come before the Commission again in the near future, depending on what the FCC decides in the matter of the CALLS proposal that is pending at that agency.

79. AT&T requested the Commission prohibit U S WEST from selling any of its exchanges for three years after the close of the merger. The Commission determines this issue to be irrelevant to and outside the scope of this proceeding. The Commission notes there is a pending docket to consider the sale of several U S WEST exchanges to Citizens Communications (D2000.1.11). AT&T and McLeod had the opportunity to intervene in that docket, but chose not to.

80. AT&T (and McLeod) also recommended the merged company be prohibited from passing any merger-related costs to Montana ratepayers as a result of the merger. U S WEST has indicated it does not intend to pass any merger transaction costs to Montana ratepayers.¹⁵ The Commission agrees merger-related transaction costs should not be passed on to Montana ratepayers. Therefore, the Commission determines the company shall absorb, and Montana ratepayers shall not bear, the transaction costs of the merger, including financial advisors, legal advisors, goodwill change in control payments and acquisition premiums. The Commission determines that any transaction costs incurred in connection with the merger and the transaction

¹⁵ U S WEST responses to PSC-25(c) and 109(a).

contemplated by the merger agreement will be recorded on U S WEST Inc.'s books as other operating expenses. If any such costs are recorded at the U S WEST Communications level, they will be classified as non-operating or "below-the-line" expenses. The Commission determines that recording expenses in non-operating expense accounts insulates ratepayers from merger transaction costs as such accounts have not been included in ratemaking by this Commission.

McLeod Testimony

81. Bridger Mitchell, Sarah Goodfriend and Stacey Stewart testified on behalf of McLeodUSA (hereafter McLeod). Each testified that the merger would be detrimental to the public interest, and approval should be conditioned on U S WEST and Qwest meeting certain requirements.

82. Dr. Mitchell analyzed the merger effects on competition and consumers. He argued that the merger would increase the incentive and ability of the company to circumvent regulation; degrade retail and wholesale service quality; increase the incentive to divert resources from its regulated to unregulated business units; and the incentive of Qwest to spend resources on improving local exchange competition conditions will not materialize as predicted.

83. Dr. Mitchell claimed the merged company will have the ability to circumvent regulation because of its asymmetric information flow capability, where misinformation allows the merged company to divert resources from the regulated to unregulated divisions resulting in cross-subsidization and inefficient resource use.

84. The merger will greatly and suddenly increase the size and scope of the new company's operations in out-of-region markets not currently regulated at the state level. Thus, Dr. Mitchell argued, larger economies of scale and scope will increase the information asymmetries, which, in turn, will result in more complex regulation. Likely resource constraints will inhibit regulators' ability to monitor and evaluate the company's behavior, even to pre-merger levels. Dr. Mitchell contended the company would gain greater leeway to impute disproportionate amounts of its total costs to its regulated activities and thereby obtain undue increase in profits.

85. Dr. Mitchell believed that wholesale service quality will most likely deteriorate after the merger because U S WEST will have the ability and the incentive to manipulate the quality of its service by: (1) postponing or delaying collocation installations; (2) delaying the

processing of orders; (3) lowering interconnection quality; and (4) selecting technology that is incompatible with competitors. The result will be that few customers are willing to switch to a alternate carrier despite U S WEST's poor service quality.

86. On merger efficiency gains, Dr. Mitchell argued that the Applicants have not provided any clear evidence that the merger would produce benefits. Any efficiency gains vanish when the Section 271 restrictions are taken into account and argued the rationale of the transactions depends on the merged company obtaining Section 271 relief. Because Qwest's network does not extend to Montana, the incentive of Qwest to spend resources on improving local exchange competition conditions will decrease for three reasons: (1) Qwest has an incentive to divert resources away from the local network; (2) Qwest has an incentive to provide poor service quality to wholesale competitors, especially those that gain market share; and, (3) Qwest will spend its resources in profitable markets where its network is present, not in Montana.

87. Dr. Mitchell suggested two possible ways to reduce the negative impacts of the merger. First, the combined company should be required to structurally separate its wholesale and retail business units, which would eliminate the U S WEST's incentive to discriminate against the CLEC in favor of its retail division. Second, the Commission ought to adopt an effective service quality-monitoring plan, making use of existing performance measurements, benchmarks and statistical methods. The Applicants should also commit to enforceable service quality penalties, according to Dr. Mitchell.

88. Mr. Stacey Stewart testified for McLeod that U S WEST's poor wholesale service quality will increase as emphasis is placed on more profitable product markets outside of U S WEST's 14-state region. He contended that the perceived Section 271 incentive will not materialize in Montana because of Qwest's lack of network in the state.

89. Mr. Stewart argued that without strong enforceable post-merger commitments, and given Qwest's plans to utilize revenues to fund its out-of-region high-margin broadband business, the merger will result in a further deterioration of U S WEST's provisioning of wholesale inputs and neglect of its basic local exchange network. He contended that U S WEST gains unfair advantage because it offers inferior service quality at the same cost.

90. Mr. Stewart challenged the Applicants' claims that the merger will result in increased incentives for the company to meet the requirements of Section 271. It is highly questionable Montana will be the focus of the merged company's interLATA business plan because Qwest has little or no network in Montana. He predicted that Montana will not receive the investments in facilities and/or service that Section 271 requires, because the resources will be directed to more profitable markets, outside Montana.

91. Mr. Stewart recommended that the Commission require the following merger conditions: (1) specific guaranteed minimum levels of investment in network infrastructure and systems to meet the needs of U S WEST's wholesale customers; (2) OSS commitments which should include a flow-through ordering mechanism for facilities and services; (3) prompt structural separation of wholesale and retail functions; (4) a commitment to implement mechanisms for guaranteed firm order commitment dates for wholesale customers with meaningful penalties and sanctions when missed; and, (5) an arbitration process conducted by industry experts for rapid and inexpensive dispute resolutions. According to Mr. Stewart, the proposed conditions are necessary to ensure that competition in Montana's local exchange market develops and that U S WEST maintains its commitment to Montana.

92. Dr. Sarah Goodfriend testified for McLeod on the expected merger effects on state commissions' regulatory effectiveness; wholesale and retail service quality standards; and the ability to regulate in the public interest. She recommended that the Commission require U S WEST to commit to network investments and service quality improvements for both wholesale and retail customers. She testified conditioning the merger would assure in-region retail and unaffiliated wholesale customers will not be discriminated against for critical service quality or other critical monopoly services as a consequence of the merger.

93. Dr. Goodfriend testified that in a competitive market, suppliers can be expected to maximize consumer satisfaction because least cost production ensures individual customers obtain preferred (i.e., low cost-high quality) product combinations. However, in a monopoly market this linkage is lost due to the captive customer situation for essential services. Regulatory efforts try to create a regulatory structure that restores the role of quality services at least cost to the monopoly by convincing the monopolist its best strategy is to offer desired service quality to all customers.

94. Dr. Goodfriend described difficulties faced by regulators in achieving sufficient service quality from regulated monopolists. She buttressed her colleagues' conclusions that regulators find it difficult to regulate U S WEST because the company maintains and directs information flow. She recommended the Commission create a roadmap for Section 271 compliance, which will require the merged company's compliance with Section 251 and 252 requirements.

95. Dr. Goodfriend argued that the merger will adversely affect the Commission's ability to regulate in the public interest because: (1) significant vertical integration is expected; (2) management will change; (3) significant product complement and substitutes exist between the two companies; and, (4) capital and labor resources will be re-deployed. Each of these four factors suggests a more tightly integrated firm, which through constant re-organization might behave in way to circumvent regulatory oversight in costing, pricing, unbundling and interconnection that may lead to inefficient resource allocation to the newly-affiliated operation. She predicted that tracking of personnel and investment resources will become more difficult, which, left unchecked, may cause discrimination directed at unaffiliated rival entrants.

96. Dr. Goodfriend testified that the Commission should require U S WEST/Qwest to make binding commitments necessary to assure service quality and safeguard the Commission's regulatory effectiveness in advancing the provisions of the 1996 Telecommunications Act after the merger.

U S WEST and Qwest Rebuttal

97. In rebuttal to McLeod witness Mr. Stewart, U S WEST witness Mr. Hayhurst argued that Mr. Stewart raised wholesale service quality and other issues that are not relevant to the proposed merger and that the Commission lacks jurisdiction over the merger. He noted that McLeod is not a wholesale customer of U S WEST's in Montana and therefore has no Montana-specific evidence to offer. He commented that Stewart's claims that U S WEST has denied or limited access to collocation, necessary Centrex features, voice mail offerings and network access registers are not true because these services are available to McLeod in interconnection agreements or tariff. He disputed Mr. Stewart's contention that U S WEST insists on trivial amendments to interconnection agreements and has delayed implementing those agreements by

pointing out that U S WEST has entered into 69 agreements in Montana and most of those were negotiated rather than arbitrated.

98. Mr. Hayhurst denied Stewart's allegations that U S WEST provides poor repair service to wholesale customers. He said U S WEST provides repair to CLECs in substantially the same time and manner as it does to its retail customers. He claimed that in Montana in 1999 75% of all out-of-service trouble reports for CLECs were cleared within 24 hours and 92% within 48 hours, which he said is comparable to the 79% and 93% performance respectively for retail customers. He disputed Mr. Stewart's claim that U S WEST's service performance comes up short when compared to McLeod's experience with Ameritech by asserting that U S WEST's service results for Montana in 1999 compare favorably with what McLeod claimed to receive from Ameritech.

99. Contrary to the claims that the merged company will not improve service quality, the merged company will offer customers more choices and greater access to advanced telecommunications and will be able to rapidly respond to the needs of customers. Mr. Hayhurst stressed the importance to the merged company of obtaining Section 271 approval to offer interLATA services in the region, which he said creates a huge incentive for U S WEST to improve wholesale service quality.

100. Mr. Hayhurst testified that it is unnecessary for the Commission to adopt conditions or require commitments from U S WEST/Qwest prior to granting merger approval, because the Act and FCC orders have established regulatory mechanisms for U S WEST to comply with market opening requirements. Further, the Commission is able to address any of these issues in other more appropriate proceedings.

101. Qwest's witness Paul Gallant challenged McLeod's claims that the merged company will not attempt Section 271 relief, but will instead simply choose to be an incumbent local exchange carrier. Competition will cut into the company's local market share and the only way to offset this lost revenue is through gaining access to the interLATA market. Potential toll revenues outweigh inevitable local market share losses. Post-merger Qwest will be unable to offer one-stop shopping and end-to-end interLATA services unless it obtains Section 271 relief. This and the fact that Qwest has constructed a nationwide fiber optic network dispute intervenor claims the merged company will remain an ILEC and not seek interLATA relief. Because Qwest

will retain its high-capacity network, it will be able to immediately enter the interLATA market once Section 271 approval is gained. He predicted that both the unit cost of providing interLATA service and the incremental variable costs will be lower than if the merged company had to construct a facility-based network or depend on resale. He argued that Intervenor claims that the merged company will delay Section 271 approval in Montana are wrong, because the opportunity costs of not entering the interLATA market far outweigh the entry cost. He cited U S WEST's Section 271 collaborative workshop process as indication of the combined company's commitment to the Section 271 process.

102. Mr. Gallant also rebutted the assertions of McLeod's witness Mr. Mitchell that the merged company will ignore its local telephone operations. He said that Qwest is purchasing U S WEST's customer base and ignoring this base would be unwise because poor service quality leads to increased customer displeasure and decreased customer retention and market growth.

COMMISSION DECISION

103. The McLeod witnesses recommended that the Commission require the combined company to structurally separate its wholesale and retail business units. However, McLeod failed to develop the record and adequately explain how this Commission would separate these business units. The Commission does not make a determination on the merits of McLeod's request, recognizing that separation may be needed in the future. Because the record was underdeveloped, the Commission dismisses McLeod's request for separation.

104. The Commission makes the same determinations made for AT&T's similar recommendation on McLeod's request that the Commission adopt an effective wholesale service quality monitoring plan, which makes use of existing performance measurements, benchmarks and statistical methods. Likewise, on McLeod's recommendation that the Commission require U S WEST to make specific and guaranteed minimum levels of investment in its network infrastructure and systems as a condition of the merger, this issue was addressed in the discussion of AT&T's recommendations earlier in this order.

105. On McLeod's request for the Commission to establish operational support system (OSS) commitments that include a flow-through ordering mechanism, the Commission determines that this issue is outside the context and scope of this proceeding. U S WEST's compliance with fully opening its OSS to competitors is currently the subject of the Regional

Oversight Committee's (ROC's) collaborative effort. Many CLECs are participating in the ROC-OSS testing effort, including McLeod. The Commission dismisses McLeod's request that the Commission address OSS issues in this order, because the issue is better addressed in a future Section 271 proceeding.

106. McLeod requested the Commission require the merged company to implement mechanisms for guaranteed firm order commitment dates for wholesale customers with meaningful penalties and sanctions when missed. Again, the Commission denies McLeod's request. This issue is outside the scope and context of this proceeding. The Commission fully expects this issue to be part of the current ROC-OSS collaborative and any future Section 271 proceeding.

107. McLeod recommended that the Commission implement an arbitration process conducted by industry experts for the rapid and inexpensive resolution of disputed issues. The Commission agrees that expedited and a streamlined dispute resolution process is important for the development of effective local competition. An expedited process to resolve disputes between CLECs and U S WEST, whether that process is conducted by industry experts or by the use of a yet-to-be-established Commission process continues to be a concern of this Commission. This issue has arisen in the course of Commission discussion of a CLEC formal complaint against U S WEST. The continued assessment of this issue is important to the development and promotion of competition in Montana. The Commission will continue to consider the need for an expedited dispute resolution process. However, the Commission deems it unnecessary to require such a condition of the merger.

108. McLeod expressed concern that the merged company will have the ability and incentive to circumvent regulation by withholding information from the Commission or by providing incomplete or inaccurate information. The Commission and its staff have continued to experience difficulty in obtaining information from U S WEST. The merger may increase the likelihood that the information flow from the company to the Commission will continue to be asymmetric. However, the Commission possesses and will continue to possess the ability to audit, analyze and research the company after the merger. The complexity of the task will no doubt become more difficult as unregulated and regulated divisions within the merged company

become blurred, but the FCC and the Montana Commission have rules in place to diminish such blurring of these business units.

109. The Commission directs the merged company to present to the Commission updates of its local exchange and advanced network presence in Montana post merger. Updates on the status and success of the merger in Montana, including updates on how the merger is progressing, particularly its effects on Montana ratepayers, should ensure that proper division among the two companies and business units continues and that the Commission remains fully apprised of the status of the Montana network post merger.

110. The Commission imposes the following updating requirements on the merged company once the merger is consummated:

(a) In regard to its local network, the Commission determines that for a period of three years following the closing of the merger, U S WEST or its successor within Qwest will meet and discuss with Commission and/or its staff annually the status of U S WEST's Montana capital investment budget and planning in its local exchange and access network. The discussions will address the status of U S WEST's provisioning of local exchange and access infrastructure investments, including, but not limited to, the status of the merged companies' investment in urban, rural, insular and tribal areas. Interested parties shall be informed of the meeting and allowed to participate. The first such meeting will occur six months after the closing of the merger and semiannually thereafter.

(b) Regarding the deployment of advanced services in Montana, the Commission determines that the company will commit for a period of three years following the closing date of the merger, that U S WEST or its successor in Qwest will file a report with the Commission and or its staff annually on the status of the rollout of new and or advanced or emerging services in Montana. The report will address at a minimum, but not limited to, the status of U S WEST's provisioning of advanced services including DSL, Asynchronous Transfer Mode (ATM) and line sharing. The company may request and the Commission may grant a protective order for this report pursuant to provisions of § 69-3-105 9(2) , MCA.

(c) Within six months after the closing date of the merger, U S WEST will file a report with the Commission and/or its staff that will describe how the merger is being implemented, transaction team progress and organizational changes including, but not limited to,

the specific impacts on U S WEST's Montana operations and customers. The company will advise the Commission of any modifications that materially and directly affect the company's Montana regulated operations or customers occurring within three (3) months after the closing of the merger. The company may request and the Commission will grant a protective order for this report pursuant to the provisions of § 69-3-105 (2), MCA.

(d) In addition to the already required reporting requirements, the intervenors have suggested that the Commission monitor the merged company post merger to make sure resources are not being redirected from its regulated to unregulated business units. The Commission expects the merged ILEC to present to the Commission updates of its local exchange and advanced network presence in Montana post merger. Additionally, the Commission expects updates on the status and success of the merger in Montana, including updates on how the merger is progressing particularly its effects on Montana ratepayers.

Montana Consumer Counsel (MCC)

111. MCC witness Allen Buckalew testified in support of the merger, but recommended two conditions: (1) approval should be contingent on U S WEST's satisfying all of the Section 271 checklist requirements in order to open the door to competition; and, (2) the Commission should monitor U S WEST's financial performance to see that merger savings are passed on to consumers and should monitor also the company's operational performance in delivering network services and wholesale services.

112. Mr. Buckalew analyzed what he asserted was the most important issue: the impact of the merger on competition. He concluded that Qwest's acquisition of U S WEST would have few competitive consequences in either the local or toll markets. He testified that the major anti-competitive consequence of the merger will be the termination of an insignificant amount of potential competition between Qwest and U S WEST in local and toll markets.

U S WEST/Qwest Rebuttal

113. Qwest witness Gallant responded that interexchange carriers will enter the local exchange market faster offering bundled local and toll services because of U S WEST's accelerated plan to enter the interLATA toll market. Conditioning the merger on meeting 271 requirements as proposed by MCC would delay, rather than accelerate, competition and would very likely reduce benefits to Montana consumers. The Commission should not inject such a

complex and resource-intensive inquiry into this merger proceeding, which would harm Montana customers for the following four reasons: (1) U S WEST would be deprived of Qwest's interLATA marketing; (2) systems could not be integrated until after approval thus causing undue delay; (3) it would inject delay and uncertainty into the merger process; and, (4) the company would be deprived of many of the cost savings and synergies that would otherwise accrue. Mr. Gallant believed that the final reason was most important.

114. Mr. Gallant testified that the merger creates no meaningful loss to competition in the interLATA market because of the plethora of interexchange carriers available and Qwest's relatively low Montana customer base - 15,453 residential and 277 business customers. As for the local exchange market, since actual competition has not developed, there will be no lessening of local exchange competition and, because the telecommunications industry is dynamic, many alternative carriers pose a very significant threat of potential competition. In fact, with Section 271 approval, CLECs will have every opportunity to enter and compete for Montana business.

115. Qwest/U S WEST witness William Taylor also recommended against MCC's request to condition the merger on Section 271 approval. Additionally, from an economic perspective, market demand should determine where the post-merger Qwest invests any cost savings or synergies. Micromanaging the merger flies in the face of the competitive paradigm this Commission is striving to achieve. Dr. Taylor labeled Mr. Buckalew's Section 271-approval condition superfluous and unnecessarily burdensome. The merger should be coincident with, not contingent upon, the effort to receive Section 271 approval.

COMMISSION DECISION

116. MCC's recommendation that merger approval be contingent upon U S WEST's successful compliance with all of the checklist items contained in Section 271 is draconian and would not allow possible benefits that flow from the merger to be passed on to end users. In lieu of MCC's request, the Commission imposes the following conditions: No later than 120 days after the issuance of the ROC report confirming the successful testing by the ROC of U S WEST's OSS, U S WEST will file with the Commission notification that it will file for Section 271 approval with the FCC for Section 271 relief in Montana.

117. The Commission also determines that U S WEST will fully fund a Montana-specific independent test of U S WEST's OSS if the Commission determines that additional

performance testing beyond the ROC OSS test is required. U S WEST may reserve the right to advocate positions in support of or in opposition to the ROC performance testing.

118. Both McLeod and AT&T recommended the Commission condition the merger on the commitment of U S WEST to open its network up to competitors, which will allow competitors to effectively compete in Montana with the merged company. The Commission reiterates that this issue will be more appropriately addressed in a Section 271 proceeding and declines to address it in this proceeding. The Commission notes that the ROC is currently working with U S WEST, interexchange carriers and CLECs developing a comprehensive test of U S WEST operation support systems. The process is not expected to be complete before the end of this year. AT&T and McLeod have been full participants in this process and the Commission expects their continued involvement.

119. In response to MCC's recommendation that the company's financial performance be monitored after the merger, the Commission determines that it already monitors the financial performance of U S WEST through the filing of its annual reports and has the authority to audit U S WEST at its discretion. At the time of U S WEST's next cost of service rate case, the Commission will review the extent to which expense synergies and cost savings are achieved in the Montana operations and, at that time, merger effects will be reflected in customers' rates. U S WEST has not filed a full cost of service rate case with this Commission since 1990 (Docket No. D90.12.86). The Commission believes that U S WEST is overdue for a cost of service rate case and urges U S WEST to file a full revenue requirements case. In the event that U S WEST seeks an alternative form of regulation (AFOR), the Commission expects U S WEST to file a revenue requirements/cost of service rate case as part of that proceeding. The Commission's ability to monitor U S WEST's financial performance will not change due to the merger; therefore, MCC's suggestion is dismissed.

120. MCC's recommendation that post-merger service quality be monitored was addressed in the section of this order regarding AT&T's recommendations.

Public testimony in Helena

121. In a letter received by the Commission on March 20, 2000, Montanans For Competitive Telecommunications claimed U S WEST's service quality is poor and that the

merger presented an opportunity to require the company to provide improved service. The organization recommended the Commission attach the following conditions:

- A requirement that the merged company replaced its analog switches in Montana with digital ones and connect every central office to a fiber optic network.
- A requirement that the merged company clear the current backlog of held orders by October 1, 2000.
- A requirement that the merged company operate under a consumer bill of rights and report to customers on its service quality performance.
- A requirement that the merged company give a customer a \$5 credit if it cannot restore an out-of-service condition within 2 working days and a month's credit if restoral takes longer than a week. In addition, customers who experience excessive numbers of service problems would receive a 25-cent credit.
- A requirement that the merged company may not increase regulated telephone rates before 2005.

122. Questioned about these proposed conditions on the witness stand at the hearing, U S WEST witness Mr. Hayhurst pointed out that U S WEST's switches are already all digital and nearly all interoffice connections, are digital, but not necessarily fiber optic. He stated his belief that there were not many held orders at year-end 1999 and, in any case, the cellular loaner program offered by the company helps to mitigate held order problems for customers. Mr. Hayhurst said that U S WEST already has in place a "service guarantee program," under which customers who wait too long for repair are entitled to credits.

123. The Commission sees merit in some suggestions of Montanans For Competitive Telecommunications, but determines that U S WEST has already implemented most of them mainly at the direction of the Commission and the remainder are outside the scope of this proceeding.

124. Don Archibald, Robert E. Lee, W. Robert Korizek, Charles Vitullo, Janice Lincoln and Edward King, U S WEST Retirees, appeared and testified at the technical hearing in Helena. Don Archibald and Robert E. Lee generally testified that the pension fund should be protected. Their benefit package was part of their total compensation as U S WEST employees. Since it was part of a compensation package, the Retirees believed that the ratepayers had

contributed. They used to get ad hoc adjustments for increased cost of living, but there have been minimal increases in recent years, lagging behind the industry increases. When one Retiree who was an expert in pensions read the annual statement, he questioned administrative expenses charged to the pension, which he did not think should be covered by the plan. About the same time, the Retirees experienced an erosion of their health care benefits. There were two class-action lawsuits on the pension fund and health benefits resulting in a payback to the fund of \$8 million and a company agreement to give a written statement that those who retired before 1991 would have no reduction in their health care. However, many Retirees are still experiencing an erosion in benefits and reduced health care coverage. They were also concerned that their benefits are susceptible, while the executives are getting golden parachutes. They believed that the pensioners should have a greater share of the generous pension fund. Their primary concern, however, was for protection of the pensions that they do have.

125. Robert Korizek and Chuck Vitullo testified that they had union working agreements, contracts that they expect to be honored. Janice Lincoln testified about her concern that she not lose medical benefits. Her weekly chemotherapy is expensive. She strongly urged the Commission to ask Qwest to continue the benefits she was promised when she went out on a medical disability. Edward King testified that he has experienced difficulty with his medical benefits under his long-term disability and has had to rely on the Veterans Administration.

Missoula Public Hearing

126. Along with other interested members of the public, U S WEST retirees turned out in force at the Missoula public hearing and at the technical hearing to advocate their position regarding their pension benefits. Witnesses representing the retirees testified in regard to their concerns about how the merger will affect their pensions. The concerns raised at the hearing included, but were not limited to, increases in pension benefits, minimum pension levels and health care benefits. If the Commission approves the merger, the retirees requested that it include in the order a statement urging Qwest to honor the commitments made by U S WEST to the retirees.

127. In Missoula, U S WEST Retiree Don Chugg testified that service would certainly be good after the merger, but he is concerned about retirement benefits. He read from a summary of the pension plan that there was \$13 billion in the fund at the end of 1998 and \$12 billion at

first of year. Pensioners used to get pension adjustments, but have had only one increase of 3 percent in the last few years. He believed that it should go back to old way. Retirees' expenses go up every year. With the amount of dollars in the fund, he did not think that it would hurt Qwest to give cost of living increases. Retiree Helen I. Smith agreed with Mr. Chugg.

128. U S WEST Retiree Helen Sowrey worked 40 years for U S WEST (previously Mountain States Telephone). She testified that benefits were part of the bargaining for total compensation, and was charged against ratepayers. Ratepayers have subsidized the pension fund. Retirees relied on good faith bargaining and assumed promises would be kept. The basic part of the pension plan is secure. ERISA required very few changes in plan when ERISA passed. Now, there is a \$3 billion excess in the fund, with no company contribution required since 1986. U S WEST was raiding the fund, so the Employees filed a class action lawsuit. The next raid came when Continental Cable was acquired. Then, when U S WEST sold Continental Cable, those employees left with some of fund, but sale profits were not used to replenish the fund. One concern she had was whether present Qwest Employees have a plan and, if so, whether they would be bringing it. U S WEST established a Retired Employees Committee, but "it's kind of an eyewash." Medical benefits are also at risk. There have been growing problems with claims, especially pharmaceuticals. Fifteen percent of U S WEST stock is held by retirees, but the merger will reduce dividends. U S WEST claims that it follows the path of former Bell Operating Companies, but AT&T gives retirees a 6 percent increase annually. Retirees must pay attention to any erosion of benefits. Instead of giving employees money in their paychecks, they were given benefits. Now they are having a growing problem with medical claims. Dividends were part of the package, and now are being reduced. Ms. Sowrey asked who is paying the golden parachutes – ratepayers? U S WEST Retiree Joann Salyer testified that she concurs completely with Ms. Sowrey.

129. U S WEST Retiree Ernest Kradolfer inquired what had happened with the Duetshe Telecom offer. David Line testified that he was concerned about rural Montana. He believed that more services should be available in the rural areas. Jim Erikson, CEO of Streaming Solution based in Cutbank, approves of the merger. His company is trying to get connectivity throughout the state, using cooperatives, U S WEST, MAIN, VisionNet, universities and the state of Montana. The goal is to provide TV quality Internet video. Tomorrow, there

will be the ability to stream content out of Rome. U S WEST's tie into Qwest's national/international network will allow them to grow and will make it easier for them and others.

130. Russ Fletcher, CEO of Health Directory in Missoula, testified that none of Qwest's network is in Montana. He has participated in the Missoula Tech Forum and wants to know plans for roll out and service quality in Montana. The T1 line from U S WEST took 8 weeks, so the company wanting this line moved to Texas. He testified that there are held orders for business installations. A 40-day contract takes up to eight weeks. Service level has to improve. He believed that Deutsche Telecom backed off from its proposal to acquire Qwest because of Idaho and Montana. His own business found the U S WEST Internet service bad, and it went with an independent vendor.

U S WEST/Qwest Response

131. Mr. Hayhurst responded for U S WEST that the pension fund is protected. He admitted that the rural issue presents difficulties. The small communities that U S WEST serves are more costly, requiring longer lines for fewer customers. U S WEST will continue to serve those rural areas in its service territory. He stated that if the rural cooperatives or independents purchased the service in the rural areas, they would have the advantage of access to funds to subsidize their services to high cost areas. Mr. Hayhurst asked whether it might not be better for cooperatives or independents to provide service in these rural areas.

132. U S WEST has responded to the pensioners' concerns that its pension plan is a qualified plan covered under the Internal Revenue Service laws. The pension plan is administered in accordance with all applicable sections of the federal law -- the Employee Retirement Income Security Act (ERISA), as well as all provisions of the pension plan document. In accordance with the plan, assets may only be used for the benefit of the plan participants and their beneficiaries. U S WEST further stated the merger with Qwest will not change the investment objectives of the Trust and that all assets will continue to be managed for the benefit of participants and their beneficiaries. No assets will be used as investment capital by the corporation, or to pay outstanding debts or obligations, other than for payment of U S WEST pension or other benefits as permitted by the plan, federal IRS code, and ERISA.

COMMISSION DECISION

133. The Commission appreciates the concerns of the U S WEST retirees regarding the protection of their pension plan. The Commission urges U S WEST and Qwest to honor the commitments made by U S WEST to the Retirees and to assure that U S WEST Retirees' earned pension benefits and health plan benefits will not be reduced. The Commission also expects that no pension assets will be used as investment capital by the corporation, or to pay outstanding debts or obligations, other than for payment of U S WEST pension or other benefits as permitted by the pension plan, the IRS code, and ERISA.

CONCLUSIONS OF LAW

1. The Montana Public Service Commission (Commission) has jurisdiction over the parties in this proceeding pursuant to Title 69, Chapter 3, Montana Code Annotated (MCA). U S WEST is a regulated public utility pursuant to § 69-8-101, MCA. The Commission is invested with full power of supervision, regulation and control of public utilities, as provided in this chapter. § 69-3-102, MCA.

2. In addition to the modes of procedure prescribed in particular cases, the Commission has the power to regulate the mode and manner of all investigations and hearing of public utilities and other parties before it. § 69-3-103, MCA.

ORDER

WHEREFORE, the Commission issues the following order:

1. The Commission will address AT&T's proposals for merger conditions related to U S WEST's Section 251/252 local competition obligations when U S WEST seeks a positive recommendation from this Commission to the FCC on a future Section 271 relief application. The issues of McLeod and AT&T on U S WEST's opening its network up to its wholesale customers, service quality provided by U S WEST to wholesale customers, and a post-Section 271 entry performance assurance plan will be addressed in the future Section 271 proceeding. These issues are outside the scope of Docket No. D99.8.200.

2. The Commission rejects MCC's recommendation the Commission require the merged company to successfully meet Section 271 requirements prior to approval.

3. The Commission imposes the following condition on U S WEST after the merger to ensure the company follows through on its statements that the merger gives it a huge incentive

to obtain Section 271 approval. No later than 120 days after the issuance of the ROC report confirming the successful testing by the ROC of U S WEST's OSS, U S WEST will file with the Commission notification that it will file for Section 271 approval with the FCC for Section 271 relief in Montana.

4. The Commission requires U S WEST to fully fund a Montana-specific independent test of U S WEST's OSS if the Commission determines that additional performance testing beyond the ROC OSS test is required. U S WEST may reserve the right to advocate positions in support of or in opposition to the ROC performance testing.

5. The Commission requires U S WEST's actual gross construction expenditures for calendar years 2001 and 2002 to be maintained at least at the level of the historic 5-year average (1995-1999) of actual gross construction expenditures (minus the Tele-Tech expenditures for years 1995 and 1996). In order to determine the historic 5-year average expenditure level, U S WEST is directed to file a report of each of those year's Montana actual gross construction expenditures with the Commission within 10 days of this order.

6. The Commission directs U S WEST to budget its capital expenditures in Montana for the next two calendar years at least at the same level as they have been the past two calendar years. This direction means that U S WEST will budget a minimum of \$50 million in each of the next two calendar years (2001 and 2002) for capital expenditures in Montana for infrastructure modernization and maintenance to maintain existing levels of service and to achieve telephone service improvement. The \$50 million amount retains the 1999 and 2000 Montana-budgeted capital expenditure level, an amount that was provided by U S WEST witness Mr. Hayhurst at the hearing (Tr. pp. 117-120).

7. U S WEST also is directed to retain its cellular loaner alternative/bill credit program for held order customers that is now in effect for no less than two years following the merger closing date unless the Commission and U S WEST mutually agree otherwise.

8. The Commission determines the company shall absorb, and Montana ratepayers shall not bear, the transaction costs of the merger, including financial advisors, legal advisors, goodwill change in control payments and acquisition premiums. The Commission determines that any transaction costs incurred in connection with the merger and the transaction contemplated by the merger agreement will be recorded on U S WEST Inc.'s books as other

operating expenses. Such costs recorded at the U S WEST Communications level will be classified as non-operating or so called “below-the-line” expenses. The Commission determines that recording expenses in non-operating expense accounts insulates ratepayers from merger transaction costs as such accounts have not been included in ratemaking by this Commission.

9. The Commission monitors the financial performance of U S WEST through the filing of its annual reports and has the authority to audit U S WEST. At U S WEST’s next cost of service rate case, the Commission will review the extent to which expense synergies and cost savings are achieved in the Montana operations and, at that time, merger effects will be reflected in customers’ rates. U S WEST is overdue for a cost of service rate case. Upon seeking an alternative form of regulation (AFOR), U S WEST is expected to file a revenue requirements/cost of service rate case as part of that proceeding.

10. The Commission expects U S WEST and Qwest to continue to honor the commitments made by U S WEST to the retirees and to assure that U S WEST retirees’ earned pension benefits and health plan benefits will not be reduced. The Commission also expects that no pension assets will be used as investment capital by the corporation, or to pay outstanding debts or obligations, other than for payment of U S WEST pension or other benefits as permitted by the pension plan, the IRS code, and ERISA.

11. The Commission directs the merged company to present to the Commission updates of its local exchange and advanced network presence in Montana post merger. The Commission requires updates on the status and success of the merger in Montana, including updates on how the merger is progressing -- particularly its effects on Montana ratepayers. This process should ensure that proper division among the two companies and business units continues and that the Commission remains fully apprised of the status of the Montana network post merger.

12. The Commission imposes the following updating requirements on the merged company once the merger is consummated:

(a) Local network: For a period of three years following the closing of the merger, U S WEST or its successor within Qwest will meet and discuss with Commission and/or its staff annually the status of U S WEST’s Montana capital investment budget and planning in its local exchange and access network. The discussions will address the status of U S WEST’s

provisioning of local exchange and access infrastructure investments, including, but not limited to, the status of the merged companies' investment in rural, insular and tribal areas. Interested parties shall be informed of the meeting and allowed to participate. The first such meeting will occur six months after the closing of the merger and semiannually thereafter.

(b) Deployment of advanced services in Montana: For a period of three years following the closing date of the merger, U S WEST or its successor in Qwest will file a report with the Commission and or its staff annually on the status of the rollout of new and or advanced or emerging services in Montana. The report will address at a minimum, but not be limited to, the status of U S WEST's provisioning of advanced services including DSL, Asynchronous Transfer Mode (ATM) and line sharing. The company may request and the Commission may grant a protective order for this report pursuant to § 69-3-105 9(2), MCA.

(c) Merger report: Within six months after the closing date of the merger, U S WEST will file a report with the Commission and/or its staff describing how the merger is being implemented, transaction team progress and organizational changes including, but not limited to, the specific impacts on U S WEST's Montana operations and customers. The company will advise the Commission of any modifications that materially and directly affect the company's Montana regulated operations or customers occurring within three (3) months after the closing of the merger. The company may request and the Commission will grant a protective order for this report pursuant to § 69-3-105 (2), MCA.

DONE AND DATED this 8th day of May, 2000, by a vote of 5 -0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

DAVE FISHER, Chairman

NANCY MCCAFFREE, Vice Chair

BOB ANDERSON, Commissioner

GARY FELAND, Commissioner

BOB ROWE, Commissioner

ATTEST:

Kathlene M. Anderson
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision.
A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.